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No. 68.

In the Supreme Court of the United States.

OCTOBER TERM, 1929.

JESSE W. CLARKE, COLLECTOR OF INTERNAL REVENUE FOR THE TWENTY-FIRST DISTRICT OF NEW YORK,

Petitioner,

against

THE HABERLE CRYSTAL SPRINGS BREWING COMPANY,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE HABERLE CRYSTAL SPRINGS BREWING COMPANY, RESPONDENT.

ARTHUR A. BALLANTINE,
GEORGE E. CLEARY,
Attorneys for THE HABERLE CRYSTAL SPRINGS BREWING COMPANY,
Respondent.

The Evening Post Job Printing Office, Inc., 154 Fulton St., New York, N. Y.

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IN THE

Supreme Court of the United States,

OCTOBER TERM, 1929.

No. 68.

JESSE W. CLARKE, Collector of Internal Revenue for the Twenty-first District of New York,
Petitioner,

AGAINST

THE HABERLE CRYSTAL SPRINGS BREWING COMPANY,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE HABERLE CRYSTAL SPRINGS BREWING COMPANY, RESPONDENT.

This case comes before the Court on a writ of certiorari granted May 13, 1929 (R. 310), 279 U. S. 832, and involves a suit by respondent brought in the United States

District Court for the Northern District of New York, for the recovery of Federal income and profits taxes paid for the fiscal year ended May 31, 1919. The petitioner is sometimes referred to herein as the defendant and the respondent as the taxpayer.

Opinions Below.

Circuit Court of Appeals for the Second Circuit, Opinion, 30 F. (2d) 219 (R. 303);

District Court, Northern District of New York, Opinion, 20 F. (2d) 540 (R. 233);

Referee, Findings of Fact and Conclusions of Law (R. 202-213); Opinion (R. 224);

The referee found that the taxpayer was entitled to judgment for $16,618.08 with interest and costs (R. 213). The District Court dismissed the complaint (R. 219). The Circuit Court of Appeals reversed the judgment of the District Court and directed entry of judgment for the taxpayer on the referee's report (R. 309).

Jurisdiction.

The Court has jurisdiction under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925 (c. 229, Section 1, 43 Stat. 938). The decree of the Circuit Court of Appeals was filed January 21, 1929 (R. 309). The petition for a writ of certiorari made by the defendant was based on the ground that decisions by other Circuit Courts of Appeals conflict with the decision in the instant case (see p. 8 below).

Question Presented.

Does Section 234(a) (7) of the Revenue Act of 1918 permit taxpayer, a brewing company, to deduct a reasonable allowance for the exhaustion, including obsolescence, of its good will, from gross income of the year ended May 31, 1919, it having become certain prior to that period that the useful life of the good will would be terminated by January 16, 1920 because of prohibition legislation?

The Statute Involved.

The Revenue Act of 1918, c. 18, 40 Stat. 1057, 1077, provides in part as follows:

> "Section 234(a). That in computing the net income of a corporation subject to the tax imposed by Section 230 there shall be allowed as deductions:
>
> * * * * * *
>
> (7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence; * * *."

Statement of Case.

The findings of fact made by the referee in the suit in the District Court appear at pages 202-213 of the record. No question is raised by the petitioner as to the facts.

Important facts not adequately covered by the petitioner's statement are as follows:

The actual value on March 1, 1913, of the taxpayer's good will was not less than $174,482.64 (R. 206). The

taxpayer earned substantial net income in every year from 1908 to 1919 (R. 205, 207). The taxpayer made no net profit but sustained net losses in each accounting period after October 28, 1919, the date upon which the manufacture and sale of beer and ale was prohibited by Federal prohibition legislation (R. 207).

After national prohibition became effective by Federal legislation the taxpayer had no good will, and the value of its good will was wholly destroyed by prohibition legislation (R. 207). Early in 1918 the officers of the taxpayer became satisfied that prohibition was imminent and took steps to reduce the taxpayer's assets to cash, and to prepare for the eventual total or partial liquidation of the company (R. 209). The taxpayer was compelled to cease the business of the manufacture, sale and marketing of beer and ale in October, 1919, by reason of Federal prohibition legislation, and went into voluntary liquidation on December 31, 1920 (R. 202).

The parties have agreed that if any deduction from taxpayer's income for the fiscal year ending May 31, 1919, for obsolescence of good will, is allowable under the statute, such deduction shall be 365/715ths of the value of such good will on March 1, 1913 (R. 206). The numerator of the fraction is the number of days in the fiscal year 1919; the denominator of the fraction is the number of days from January 31, 1918, when it became reasonably apparent that national prohibition would be adopted, to January 16, 1920, when the prohibition amendment became effective (R. 206). This period had been fixed by the Bureau of Internal Revenue in T. B. R. 44, 1 C. B. 133.

The taxpayer made no profit from the cereal beverage

and soft drink business conducted by it from October, 1919, to December, 1920 (R. 207). Very little of these products were sold, they had to be sold to a new trade, and in bottled form, which was expensive and unprofitable (R. 210). The taxpayer's good will was wholly destroyed by prohibition legislation (R. 207).

The entire amount of tax in controversy turns on the answer to the single question above stated and the question is wholly one of statutory construction.

Preliminary Statement as to Rulings of Bureau of Internal Revenue and Lower Court Decisions.

Since the enactment of the Revenue Act of 1918 (February 24, 1919), the Bureau of Internal Revenue has consistently held and now holds, that Section 234(a)(7) of that Act, and identical provisions of later acts, permit the deduction from income of a reasonable allowance for exhaustion, wear and tear, including obsolescence, of intangible assets the use of which in the trade or business is definitely limited in duration.

Article 163, Regulations 45 (1919)—Revenue Act of 1918.

Article 163, Regulations 62 (1922)—Revenue Act of 1921.

Article 163, Regulations 65 (1924)—Revenue Act of 1924.

Article 163, Regulations 69 (1926)—Revenue Act of 1926.

Article 203, Regulations 74 (1929)—Revenue Act of 1928.

The rulings of the Bureau never expressed any doubt as to this general position, although for a time the Bureau refused to permit the allowance to be applied in the case of leases, and since the court decision referred to below has denied its application to good will. (See Appendix A, p. 46 below.) Rulings indicating how the present controversy arose and its relation to the general position of the Bureau are briefly referred to below.

From 1919 until 1927 the Bureau of Internal Revenue held that distillers and brewers were entitled, under Section 234(a)(7) of the Revenue Act of 1918, to deduct a reasonable allowance for obsolescence of good will and similar assets from income of the years 1918, 1919 and 1920, in all cases where the useful life of such good will was, in fact, limited and the value thereof destroyed by prohibition legislation.

T. B. R. 44, 1 C. B. 133, August, 1919.
T. D. 2929, October 7, 1919.

The allowance was based on the value of the good will on March 1, 1913, if acquired prior thereto, and spread over the period January 31, 1918, to January 16, 1920.

T. B. R. 44, supra.
A. R. M. 34, 2 C. B. 31.

It is true that the original Regulations 45 (April, 1919), under the new provisions of the Revenue Act of 1918 (enacted February 24, 1919), which first provided for obsolescence deductions, made the following statement:

> "There can be no such allowance in respect of good will, trade names, trade marks, trade brands, secret formulae or processes" (Article 163).

As shown by T. B. R. 44, *supra,* when the Bureau's attention was directed to the fact that although good will and similar assets ordinarily had an unlimited life, in the unusual case of brewers and distillers affected by prohibitory legislation the good will and similar assets had a *limited useful life* in the business, the limiting sentence above quoted was dropped from the Regulations.

T. D. 2929, October 7, 1919.

This action was taken before any of the returns for the year 1918, filed in March and June, 1919, were finally audited. All 1918, 1919 and 1920 returns closed prior to 1927 were closed under regulations and rulings allowing a deduction for obsolescence of good will, where the taxpayer could satisfy the Bureau of Internal Revenue that such obsolescence had, in fact, occurred.

The general rule that allowances for exhaustion, wear and tear, including obsolescence, of intangible assets having a limited useful life were authorized by the statute, has never been attacked in the courts by the Government prior to the present case and is still in full effect in the regulations and practice of the Treasury Department. In the case of leases, the Department did making a ruling (T. D. 3414, I-2 C. B. 90, Nov. 25, 1922) that the allowance did not apply, but this ruling was revoked and exhaustion of leases allowed by T. D. 3760, IV-2 C. B. 154, Oct. 10, 1925.

The specific question as to obsolescence of good will got before the courts only in those cases where the Bureau of Internal Revenue denied that the obsolescence had, in fact, occurred. The question first arose in the courts as to a *malting* company. The malting business was not pro-

hibited, although most of the taxpayer's customers were put out of business. The District Court found that the taxpayer's good will was, in fact, destroyed as a result of prohibition, but held, contrary to rulings of the Bureau of Internal Revenue, that Section 234(a)(7) of the Revenue Act of 1918 did not authorize a deduction in any case for obsolescence of good will.

Red Wing Malting Company v. *Willcuts,* 8 F. (2d) 180 (1925).

The decision of the District Court was affirmed, *Red Wing Malting Company* v. *Willcuts,* 15 F. (2d) 626, 8th C. C. A. (1926), certiorari denied 273 U. S. 763. The denial by this court of certiorari did not, of course, constitute any expression of opinion on the merits.

United States v. *Carver,* 260 U. S. 482.

After this decision, the Commissioner of Internal Revenue amended the Regulations so as to deny a deduction for obsolescence of good will in all cases (*T. D. 4055,* August 4, 1927, IV-2 C. B. 63). The Commissioner made no change, however, in the Regulations in so far as they applied to other forms of intangible property and the Regulations so applying continued in full effect.

The Red Wing Malting Company decision was followed by other courts and by the Board of Tax Appeals largely on the basis of the reasoning of the court in that decision.

Appeal of Manhattan Brewing Company, 6 B. T. A. 952 (1927);

Landsberger v. *McLaughlin,* 26 F. (2d) 77, 9th C. C. A. (1928);

Renziehausen v. *Commissioner,* 31 F. (2d) 675, 3rd C. C. A. (1929), Certiorari granted (now No. 114, October Term, 1929).

The Circuit Court of Appeals below was of the opinion that the reasoning in the *Red Wing Malting Company* decision was unsound and refused to follow the decisions in the Eighth and Ninth Circuits and in the Board of Tax Appeals. A clear statement of the position here maintained by the taxpayer is contained in the dissenting opinion of Mr. Trammell in the *Manhattan Brewing* case, appearing at 6 B. T. A. 964.

The petitioner applied for certiorari in this case because of the conflict between the decisions in other circuits and the decision in this case by the Circuit Court of Appeals for the Second Circuit.

Summary of Taxpayer's Argument.

An outline of taxpayer's argument is set forth in the Index at the front of the Brief.

ARGUMENT.

Under Section 234(a)(7) of the Revenue Act of 1918 the taxpayer, a brewing company, was entitled to deduct a reasonable allowance for the exhaustion, including obsolescence, of its good will, from income of the year ending May 31, 1919, it having become certain prior to that period that the useful life of the good will would be terminated by January 16, 1920, because of prohibition legislation.

In petitioner's brief in this case, representatives of the Government attack the validity of the Treasury Regulations in effect since 1919, and in full force and effect today, holding that Section 234(a)(7) of the Revenue Act of 1918, and identical provisions of subsequent Revenue Acts, provide for a deduction for exhaustion, including obsolescence, with respect to patents, contracts, licenses, franchises, leases, and similar intangible property having a limited useful life (Petitioner's brief, pp. 21-24). The regulations under attack have been repeatedly and uniformly sustained and applied by the courts and the Board of Tax Appeals (see Appendix A hereto, p. 46, below for the authorities). With the regulations now under attack in effect, Congress has reenacted without change the language of the provision in question under which such regulations were made (Sections 234(a)(7) Revenue Acts 1921, 1924 and 1926 and Section 23(k) of the Revenue Act of 1928). None of the decisions of the lower courts, including the decision in *Red Wing Malting Company* v. *Willcuts,* upon which the Government seems particularly to rely, or of the Board of

Tax Appeals take the position now maintained by the Government that the obsolescence allowance applies only to tangible property. Consideration of the language and the purpose of the statute will clearly show that this novel and late contention which, if sustained, would involve the revision of many thousands of tax cases settled under the existing regulations, is not sound.

I.

The statute (Section 234(a)(7) of the Revenue Act of 1918) authorizing the allowance uses the term "property" without restriction or limitation, and this term is not confined in its application to property of such a nature that it was decreased, consumed or disposed of by use in the trade or business, but applies to all property, tangible or intangible, used in the business, which was in fact subject to exhaustion, wear and tear, including obsolescence.

The Petitioner's single specification of error is as follows:

> "The Circuit Court of Appeals erred in holding that the respondent was entitled under Section 234(a)(7) of the Revenue Act of 1918 to a deduction from its gross income for the fiscal year ending May 31, 1919, on account of the exhaustion, wear and tear or obsolescence of its good will, *since the statute only intended to embrace property of such a nature that it was decreased, consumed or disposed of by use in the trade or business*, and good will is not such property" (Petitioner's Brief, p. 5, italics ours).

(a) No restriction on the meaning of the word "property" or in the application of the obsolescence allowance to property generally, is expressed in the language of the statute.

The language of the statute providing for the deduction is as follows:

> "a reasonable allowance for the exhaustion, wear and tear of *property* used in the trade or business, including a reasonable allowance for obsolescence". Section 234(a)(7) Revenue Act of 1918, italics ours.

No limitation is expressed here on the word "property" or upon the application of the allowance to property generally.

The Government relies not upon the language of the statute in this connection but upon what is maintained to have been its "intent". The primary method of ascertaining the intention of Congress in enacting the statute is, however, to resort to the ordinary grammatical sense of the provision and the ordinary and familiar meaning of the words used. (*U. S.* v. *Union Pacific Railroad Company,* 91 U. S. 72; *Treat* v. *White,* 181 U. S. 264; *De Ganey* v. *Lederer,* 250 U. S. 376).

In connection with the consideration of the corresponding provision of the preceding Act, this Court very recently stated that

> "the plain, obvious and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense."
>
> *Lynch* v. *Alworth-Stephens Co.,* 267 U. S. 364.

In this instance the Government is not following the plain, obvious and rational meaning expressed in the pro-

vision but is endeavoring to read into it a limitation not there expressed and to give it a narrow and hidden sense.

So far as the language of the statute is concerned the word "property", which is of course the key word in this connection, is used without limitation, qualification or restriction; the sole requirement is that the property be used in the business. As this Court has itself said of the corresponding provision of the preceding Act,

> "there is nothing to suggest that the word 'property' is used in any restricted sense."
>
> *Lynch* v. *Alworth-Stephens Co., supra.*

The omission of any limitation on the word "property" is particularly significant because it is clear that Congress in enacting the statute had in mind the distinction between tangible and intangible property. Thus in Title III, War Excess Profits Tax Title of the Revenue Act of 1918, dealing with invested capital Congress defined "intangible property" as "patents, copyrights, secret processes and formulæ, good will, trade marks, trade-brands, franchises and other like property." Section 325.

Not only does the statute fail to contain a restriction of the allowance to property "of such a nature that it was decreased, consumed or disposed of by use in the trade or business", but it represents a deliberate change from a preceding provision which did express such a restriction. Section 12(a) Second of the Revenue Act of 1916 (the corresponding provision in the prior Act) provided for a deduction from income as follows:

> "A reasonable allowance for the exhaustion, wear and tear of property *arising out of its use or employment in the business or trade.*" (Italics ours.)

As will be seen by referring to Section 234(a)(7) the Revenue Act of 1918 (p. 3 above), in drafting the new section, Congress not only added the phrase "including a reasonable allowance for obsolescence" but made another significant change in omitting altogether the limitation of the allowance to that "arising out of its use or employment in the business or trade", providing instead only that the property be "used in the trade or business." See page 29 below where we treat the change from the prior statute further. The Government while basing its entire argument on an assumed intention of the statute to confine the allowance to property of such a nature that *its use* is what occasions the allowance, in its brief makes no reference to the change in the 1918 Act omitting this requirement which appeared in the previous Act.

We submit therefore that the language of the statute is entirely clear, that it contains no limitations such as the Government suggests and that the whole position of the Government is an endeavor to read into the statute limitations which are not there.

(b) The allowance for obsolescence is as necessary for the computation of income in the case of intangible property as in the case of tangible property and therefore falls equally within the "intent" of the unrestricted language of the statute which admittedly provides such an allowance in the case of tangible property.

The allowance for obsolescence provided for by Section 234(a)(7) of the Revenue Act of 1918 covers deductions from current income to offset losses to be fully sus-

tained at reasonably predictable future dates through some drastic change in external conditions which when fully operative will destroy the value of property of the taxpayer used in the business. The Government admits that the statute provides for such an allowance in the case of tangible property (Petitioner's brief, p. 6), but notwithstanding the absence of express restriction in the Act argues that such an allowance in the case of intangible property is outside of the intent of the Act. It is therefore material to consider why any allowance for "exhaustion, wear and tear * * * including obsolescence" is made.

The allowances as deductions from current net income covered by Section 234(a)(7) are different from deductions for losses actually sustained in a taxable year covered by Section 234(a)(4) and deductions for sustained "depletion" on account of the actual removal of ore, timber, oil and the like covered by Section 234(a)(9). The deductions for these items relate to completed transactions—losses sustained or physical property removed.

The allowances covered by the section here in question all relate to future losses of property used in the business which are sufficiently certain to occur to necessitate taking them into account in determining net income. If a building or a piece of machinery used in the business has, according to experience, a fixed limit to its useful life, it is obvious that in computing current income a deduction must be made for the ultimate loss of that asset. This deduction is one of those provided for by this section and is ordinarily referred to as "depreciation".

It is equally obvious that if there is used in the business intangible property such as a valuable patent or a lease or a

special contract which on some future date will reach the end of its life, true current net income cannot be computed unless this inevitable loss of this asset is taken into account through an appropriate annual allowance.

Allowances so made do not depend upon the actual decrease or shrinkage in the value of the particular property in the current year. They are not deductions on account of completed transactions during the year, they are true "allowances" to provide against a certain loss in the future. The basis of such allowances in the case of tangible property was dealt with by this Court in *U. S.* v. *Ludey,* 274 U. S. 295. Such basis was well expressed by the Board of Tax Appeals in *Appeal of Even Realty Co.,* 1 B. T. A. 355, where the Board stated:

> "When a manufacturer sells his product, he is really selling a composite of four or five things: (1) the materials entering into the product; (2) labor that has been applied to them including the effort of executives and salesmen; (3) that proportion of the value of the machinery, and of (4) the buildings which is consumed in the manufacture of the product; and (5) in some cases, a proportionate part of the monopoly granted by patents, exhausted during the process of production. Until the manufacturer has recovered the cost or basic value to him of the proportionate parts of these items attributable to a unit of his product sold, he cannot properly be said to have received income upon its sale, and only the excess of the sale price realized over the sum of these items (whatever particular form they may take) is truly income. We feel that this would be true whether the statutes made any specific provision for their deduction or not—the computation would be just as necessary to the determination of true income as the computation of profit on a

sale by reference to the cost or basic value of the article sold. (Quoting from *Doyle* v. *Mitchell Brothers Co.*, 247 U. S. 179) * * *

"Because of the difficulty of attributing to each article sold or to the sales in a taxable year an exact sum representing the proportion of basic value of machinery, buildings, patents, etc. entering into such sale, the statutes have consistently provided for a *reasonable allowance.*"

"Obsolescence" is what results to property continuously used in the business when, by some *unexpected* change, a limit is set to the period during which the property may be used. Ordinarily the useful life of property may be estimated with reasonable accuracy from the time the property is acquired. If the property be physical property the period of its probable capacity for service is known from experience. If the property be a patent, lease or contract its life is definitely fixed. Experience has shown, however, that changes affecting the business may come about which were not foreseen which, when fully operative, will end the useful life of property before it would normally end. Such a change is always external to the business itself. As the Government well states in its brief, page 26:

"Obsolescence presupposes that at a reasonably definite future date, which can be foreseen with reasonable certainty, a particular asset will finally arrive at a state of becoming useless, such uselessness not being due to exhaustion, wear or tear through use but to the fact that economic developments render it imperative that it be discarded."

Economic developments are not the sole possible cause of results here indicated: prospective legal prohibition of the

carrying on of a business is at least equally imperative. "Obsolescence" is the "state or process of becoming obsolete", and "obsolete" is "gone out of use; no longer in use" (Century Dictionary and Encyclopedia).

Obsolescence of property—that is the approaching of a previously unexpected termination of its useful life—obviously affects the determination of income in exactly the same way as the normal approach of the end of useful life. In any case where a limit has been set to the useful life of the property continuously used, whether that limit was foreseen or was originally unforeseen, the ultimate loss of the asset must be taken into account through appropriate annual allowances in reckoning current net income. Exhaustion and obsolescence being specifically provided for in Section 234(a)(7) of the 1918 Act, nothing in the nature of or reason for the allowance provided for, therefore, suggests that any limitation of its application to tangible property must be read into the statute. As the court below stated (R. 308):

> "Every consideration which justifies allowance for the 'obsolescence' of the tangibles because of the compulsory future discontinuance of the business ought to create a similar allowance for the good will."

The Government in defending its position urges that

> "In deciding such a question argument addressed to the economic wrong involved in the imposition of a tax is beyond judicial cognizance" (Petitioner's brief, p. 15).

Where the clear words of the statute involve economic wrong through its application, argument addressed to that wrong is indeed of no force. This accepted principle, how-

ever, by no means establishes that the natural and rational meaning of the statute may be discarded in favor of a hidden construction which would work an economic wrong and injustice in the application of the statute. If there is any doubt as to the meaning of the terms employed in a statute,—including terms in a tax statute which authorize a particular deduction in computing income,—that construction is to be favored which makes the statute apply consistently to all cases affected by it and which does not restrict the deduction to certain classes of cases while denying it in other cases falling equally within the principle underlying the deduction.

(c) The including of the obsolescence allowance in or with the "exhaustion, wear and tear" allowance has no tendency to show that the allowance is restricted to the obsolescence of tangible property. Exhaustion itself applies to intangible property as well as to tangible property, and the history of the statute indicates no limitation in its application.

The Government's contention is that the statute

> "only intended to embrace property of such a nature that it was decreased, consumed and disposed of by use in the trade or business" (Petitioner's brief, p. 5).

As shown above, this contention is not based upon any express limitation in the language of the statute. Nor is it based on any expression of intent to limit the natural and rational meaning of the statutory language expressed in the report of any Congressional Committee or in the report of any debate on the Act in Congress. The limitation which,

through an assumed intent, the Government seeks to place upon the word "property" appears to be based wholly on its view as to the meaning of the word *"exhaustion"*. The position of the Government appears to rest upon the following propositions:

(1) The terms exhaustion, wear and tear, in or with which the obsolescence allowance is included, mean in the dictionary sense only processes that can happen to physical property;

(2) Exhaustion, wear and tear must result from use of the property, and intangible property is not subject to exhaustion, wear and tear through use;

(3) As a matter of statutory history, the allowance for obsolescence was added to a phrase which related only to allowances for physical property and hence was intended to cover only physical property.

It is submitted that none of these propositions finds support in the language of the statute or its history.

(1) The term "exhaustion" in or with which the obsolescence allowance is included, is not confined to physical consumption, lessening or diminution of tangible property, but includes the exhaustion of the value or usefulness of intangible property having a limited useful life through lapse of time.

The word "exhaustion" does not connote merely the consumption of physical property. Ordinary dictionary definitions may look primarily to the physical meaning of

the term, but the dictionaries show that the term has a wider range of meanings. Webster's International Dictionary defines "exhausted" as *"deprived of essential characteristics or properties;* deprived of its proper qualities or virtues"; Murray's New English Dictionary defines "exhaust" as "to use up completely (either a material or immaterial thing)".

Should there be any doubt as to the meaning of the word "exhaustion" in the statute, more light as to its meaning is to be derived from the usage of that term in Federal tax practice than from dictionaries. There can be no doubt that as used for many years by the Bureau of Internal Revenue in connection with income tax statutes, the term has been accepted as covering the loss of property through the gradual expiration of its economic life and not merely through loss of physical content. In the light of that usage accepted and expressed in the regulations, the Revenue Acts of 1921, 1924, 1926 and 1928 have reenacted the exact language of Section 234(a)(7) of the 1918 Act here in question.

In *Article 137 of Regulations 33* (1914) it is stated:

> "The deduction claimed for *exhaustion* of the capital assets as represented by patents to be made in the return of annual net income of a corporation for any given year shall be one-seventeenth of the actual cost of such patents reduced to a cash basis." (Italics ours.)

Here is an early instance of the use of the word exhaustion to refer to what happens to a patent through lapse of time, notwithstanding the fact that the basis for the exhaustion allowance here prescribed is the cost of the patent.

In *Article 162 of Regulations 45* (1919) it is said:

> "The necessity for a depreciation allowance results from the fact that certain property used in the business gradually approaches a point where its *usefulness is exhausted.* The allowance should be confined to property of this nature. In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art or to becoming inadequate to the growing needs of the business." (Italics ours.)

In *Article 163 of Regulations 45* (1919) it is stated:

> "Intangibles, the use of which in the trade or business is definitely limited in duration may be the subject of a *depreciation* allowance. Examples are patents and copyrights, licenses and franchises." (Italics ours.)

The meaning of the word "depreciation" as here used is made clear by Article 161 of Regulations 45, which reads:

> "A reasonable allowance for the exhaustion, wear and tear and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred to as covering *depreciation,* excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence." (Italics ours.)

Article 167 of Regulations 45 deals specifically with depreciation of patents.

In *Appeal of Grosvenor Atterbury,* 1 B. T. A. 169, the Board of Tax Appeals said:

> "The term *exhaustion* used in all four sections properly describes the reduction in the remaining life of a leasehold as it approaches year by year, its termination." (Italics ours.)

In *Appeal of Union Metal Manufacturing Company,* 1 B. T. A. 395, the Board of Tax Appeals said, with respect to patents:

> "It may be that in some cases patents *appreciate* in value for a time and that there is no *depreciation* in the broader sense of the word, but by the very nature of a patent it is invariably subject to *exhaustion,* and the right to a deduction therefor is not precluded by the existence of an appreciation which may or may not be realized at some future time, but which is only taxable when realized. Everything we said in the *Even Realty Co. appeal,* 1 B. T. 355, with respect to deductions for wear and tear of machinery and buildings and in the *Appeal of Grosvenor Atterbury,* 1 B. T. A. 169 with respect to *exhaustion* of leases, applies equally to deductions for *exhaustion* of patents." (Italics partly ours.)

In *T. D. 3760,* IV-2 C. B. 154 (1925), the Bureau of Internal Revenue held:

> "A lessee is entitled under the Revenue Acts of 1916, 1917, 1918 and 1921 to an allowance for the *exhaustion* of a lease used in trade or business based on the value of the lease as of March 1, 1913, if acquired prior thereto." (Italics ours.)

In *Philip Henrici Co.* v. *Reinecke,* 3 F. (2d) 34, the District Court said:

> "Just as surely as time passes, the admitted $370,000 market value of this lease on March 1, 1913, will be wholly *exhausted* on April 30, 1928; and unless the plaintiff shall have had the right of deduction from year to year of this, its capital so *exhausted* in the business, it will not only have consumed in its business this capital sum, but will have been obliged to pay an income tax upon it—a result which I believe the law did not intend and does not require." (Italics ours.)

In *Appeal of Manhattan Brewing Company,* 6 B. T. A. 952, at 960, the Board of Tax Appeals said:

> "Patents, copyrights, leaseholds, and similar intangibles do not suffer any physical deterioration in use, but, as their life is limited by contract, *they decrease in value or become exhausted by the mere passage of years.* Ordinarily the annual allowances for the *exhaustion* of such property is an aliquot part of their cost or capital value at March 1, 1913, for the number of years to elapsé prior to the termination of the contract period, but in extraordinary conditions, as with tangibles, the allowance for *exhaustion* may be increased to include obsolescence." (Italics ours.)

This court in *Lynch* v. *Alworth-Stephens Co.,* 267 U. S. 364, applied the term "exhaustion" to property of an intangible nature although the allowance in the instance then before the court was measured by actual physical exhaustion. That case involved the claim of a lessee of mining property for a deduction for exhaustion or depletion of the March 1, 1913, value of its lease under the provisions of the Revenue Act of 1916. The controversy arose because

the taxpayer did not own the ore deposit. The Court held that the lessee had no title to the unextracted ore deposits, but that he owned leases conferring upon him the exclusive possession of the deposits and the valuable right to removing and reducing the ore to ownership, and that he was entitled to a deduction for the exhaustion of his interest under the leases. The Court said:

> "The general provision in Section 12(a) second, is that the deduction from gross income shall include a reasonable allowance for the 'exhaustion * * * of property'. *There is nothing to suggest that the word 'property' is used in any restricted sense.* In the case of mines, a specific kind of property, the exhaustion is described as depletion, and is limited to an amount not exceeding the market value in the mine of the product mined and sold during the year. *The interest of respondent under its leases in the mines being property, its right to deduct a reasonable allowance for exhaustion of such property, if there be any, during the taxable year results from the plain terms of the statute,* such deduction, since the property is an interest in mines, to be limited to the amount of the exhaustion of respondent's interest caused by the depletion of the mines during the taxable year.
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> * * * * * *
>
> "It is said that the depletion allowance applies to the physical exhaustion of the ore deposits, and since the title thereto is in the lessor, he alone is entitled to make the deduction. But the fallacy of the syllogism is plain. The deduction for depletion in the case of mines is a special application of the general rule of the statute allowing a deduction for exhaustion of property. *While respondent does not own ore deposits, its right to mine and remove the ore and reduce it to possession and ownership is property within the meaning*

of the general provision. Obviously, as the process goes on, this property interest of the lessee in the mines is lessened from year to year, as the owner's property interest in the same mines is likewise lessened. *There is an exhaustion of property in the one case as in the other;* and the extent of it, with the consequent deduction to be made, in each case is to be arrived at in the same way, namely, by determining the aggregate amount of the depletion of the mines in which the several interests inhere, based upon the market value of the product, and allocating that amount in proportion to the interest of each severally considered." (Italics supplied.)

While this decision of the Court necessarily applies only to a mining lease, the reasoning clearly indicates a refusal to regard the meaning of the word "exhaustion" as restricted to the consumption of physical property owned by the taxpayer. It is clear that a taxpayer cannot claim a deduction for exhaustion, wear and tear of physical property owned by some one else, even if he is a lessee of the property. *Weiss* v. *Weiner,* 279 U. S. 333.

On the basis of the decision in *Lynch* v. *Alworth-Stephens Co., supra,* the Bureau of Internal Revenue, the Board of Tax Appeals, and the lower courts have allowed deductions for exhaustion of leases, (which was denied for a time—see Appendix A, p. 47) not only of mining property, but of land and buildings, and agricultural lands.

T. D. 3760, IV-2, C. B. 154.

Appeal of Grosvenor Atterbury, 1 B. T. A. 169.

Oahu Sugar Company v. *Commissioner,* 13 B. T. A. 404.

As pointed out elsewhere in the brief, Congress through reenacting the governing provision as part of

succeeding tax statutes has in effect adopted the meaning of the word exhaustion consistently applied to it by the Bureau of Internal Revenue.

These precedents conclusively establish that the meaning of the word "exhaustion", even without enlargement to include obsolescence, cannot properly be restricted to physical consumption of tangible property. The word has no such fixed and restricted meaning.

It would be difficult to find a term other than "exhaustion" which expresses what happens to a patent, contract or lease from the standpoint of the taxpayer. No other term is in use which covers the loss of value resulting from lapse of time.

Unless the term "exhaustion" as used in Section 234(a)(7) covers the loss of value through lapse of time, it is difficult to see that it has any application in the statute. Obviously it is not used to express the same idea as "wear and tear"—it is of equal importance and is to be given its own independent weight. The limitation of "exhaustion" to "physical exhaustion", as in the case of a mine, as claimed by the Government, gives no scope for its application because exhaustion in that sense is separately dealt with under this statute as depletion (Section 234(a)(9)). Even the case of a lessee of a mining property or other natural deposit is specifically taken care of in the Revenue Act of 1918 under Section 234(a)(9). *Under the Government's contention, the word "exhaustion" serves no useful purpose in the statute.* The Government's position thus seems to violate the established canon of statutory construction that every word in the Act must be given weight.

(2) The Revenue Act of 1918 does not require that exhaustion of property result from use of the property in the business.

Section 234(a)(7) provides for "a reasonable allowance for exhaustion, wear and tear of property *used in the trade or business,* including a reasonable allowance for obsolescence". The statute does not provide that exhaustion, wear and tear must result from the use of the property. Exhaustion may result from mere lapse of time. Obsolescence of property, of course, as the Government states in its brief, never results from use, but always from a change in external conditions (see p. 17 above). The petitioner's argument that the statute applies only to property subject to exhaustion, wear and tear *by use* thus reads into the statute a requirement which is not there and logically applied reads out any obsolescence allowance in any case whatsoever.

(3) The legislative history not only does not support the petitioner's contention that exhaustion applies only to tangible property, but indicates that no such restriction was intended.

In taking the position that the allowance provided for by the section in question applies only to physical property, the Government places great reliance upon the contention that, as a matter of statutory history, the allowance for obsolescence was added to a phrase which related only to the allowance for exhaustion, wear and tear of physical property, and hence, it is contended, was intended to cover only physical property. In making this contention, however, the Government has apparently wholly ignored the

fact that, as indicated above, page 13, the language of the 1918 Act on this precise point differed radically from the language of the prior Act. In adopting the provisions of the 1918 Act Congress did away with any requirement that the allowance should result from any use of the property.

The Revenue Act of 1916, Section 12(a) Second, provided for a deduction from income as follows:

> "a reasonable allowance for the exhaustion, wear and tear of property *arising out of its use or employment in the business or trade.*" (Italics ours.)

The Revenue Bill of 1918, as passed by the House, provided, in language ultimately incorporated in the statute, for the deduction from income of

> "A reasonable allowance for exhaustion, wear and tear of property *used in the trade or business.*" (Italics ours.)

A significant change from the language of the 1916 Act was here made, specifically removing the requirement that exhaustion, wear and tear result *from use,* and making the deduction apply to all business property subject to exhaustion, wear and tear, whether resulting from use or not. This significant change in the language was made before the provision as to obsolescence was considered. This change is not referred to in the petitioner's brief.

The Senate amended the provision of the House Bill to read:

> "a reasonable allowance for *depreciation* of property used in the trade or business." (Italics ours.)

The Conference Committee changed the provision to read as it now appears in the law:

> "a reasonable allowance for exhaustion, wear and tear

of property used in the trade or business, including a reasonable allowance for obsolescence."

(See Conference Committee Print H. R. 12863, 65th Congress, 3rd Session, Sec. 234(a)(7).)

As a matter of practice, even the provision of the Revenue Act of 1916 was not in fact confined in its application to tangible property.

Lynch v. *Alworth, Stephens Co., supra;*
Kaufman-Straus v. *Lucas,* 12 F. (2d) 774;
Oahu Sugar Company v. *Commissioner,* 13 B. T. A. 404;
T. D. 3760, IV-2 C. B. 154.

The petitioner's attempt to distinguish the admitted rulings of the Treasury permitting an allowance for the exhaustion of patents under the 1916 Act on the theory that the whole cost of the patent was treated as "prepaid business expense" is unsound. The same suggestion could of course be made as to the treatment of the cost of any capital asset having a limited useful life. The suggestion ignores the fundamental accounting distinction between capital expenditures and current expenditures.

Regulations under prior acts upon which petitioner relies, denying a deduction for depreciation of good will, such as T. D. 1675, Art. 163, Regulations 33 and Articles 167 and 168 of Regulations 33 (revised) all dealt with the ordinary case where good will had an indefinite life and value. None of them dealt with cases where the useful life of the good will was definitely limited. Before the *Red Wing Malting* decision the Treasury made no distinction between patents and good will having a limited life, but on the contrary treated them as having the same status with reference to the deduction (p. 6 above).

The Government's treatment of the legislative history not only ignores the significant change in the statute, as has been pointed out, but proceeds upon the mistaken theory as to how Congress proceeded in formulating this deduction. The theory of the Government appears to be that the first and fundamental thought of the legislative body was as to the *class of property* to which the deduction should apply, and the secondary thought was as to the provisions relating to the deduction. (Petitioner's brief, p. 19.) The contrary appears to have been the case. The section provides for a deduction resulting from conditions which may affect any property, and in providing for the deductions the term "property" was used without restriction. There is not the slightest indication from the history of the statute that Congress at any time intended to deal with a particular class of property only, or to exclude any property used in the business which was in fact subject to exhaustion, wear and tear, including obsolescence.

(d) Limiting the application of Section 234(a)(7) to tangible property is contrary to uniform rulings of the Treasury Department, in force for over ten years and still in effect, which have been approved by the Board of Tax Appeals and the courts and by Congress through reenactment of the governing provisions.

In its first Regulations under the Revenue Act of 1918, the Treasury Department held

> "Intangibles, the use of which in the trade or business is definitely limited in duration, may be the subject of a depreciation allowance. Examples are patents and copyrights, licenses and franchises." Article 163, Regulations 45 (April 1919).

This language has appeared in all subsequent Regulations. Article 163, Regulations 45 (1920), Regulations 62 (1922), Regulations 65 (1924) and Regulations 69 (1926); Article 203, Regulations 74 (1929).

In T. D. 3760, IV-2, C. B. 154 (1925), the Bureau held that an allowance for exhaustion was proper as to all leases under the Revenue Acts of 1916, 1917, 1918 and 1921, although for a time it had refused to allow this deduction.

The rulings applying the statute to intangible assets, including patents, copyrights, licenses, franchises, contracts and leases have been repeatedly approved by the Board of Tax Appeals and the courts and are still in full force and effect (see Appendix A, p. 46 below). The Bureau of Internal Revenue is every day approving allowances in respect of intangible assets, now maintained here to be unauthorized. These rulings, under which the allowances are made, were accepted by Congress through reenactment of the provision without change. (See p. 10 above.) The adoption of the position now contended for by the Government, invalidating the prior rulings, would of course require a revision of the tax computation which has been made under those rulings in the case of many thousands of taxpayers.

The presumption is, of course, that the long continued uniform construction of the statute by the Treasury Department, the Board of Tax Appeals and the courts is correct—

Edwards v. *Darby*, 12 Wheat. 206;
Robertson v. *Downing*, 127 U. S. 607;
U. S. v. *Healey*, 160 U. S. 136;
U. S. v. *Falk*, 204 U. S. 143;
National Lead Co. v. *U. S.*, 252 U. S. 140.

II.

The reasonable allowance for obsolescence, authorized by Section 234(a)(7) of the Revenue Act of 1918, applied to the good will property of a brewing company, when the future destruction of that good will through the adoption of the prohibition amendment became a certainty.

(a) Good will is property used in such business.

The Government rests its case primarily on the ground that the statute does not apply to any intangible property. It does not deny that good will is property. Nor does it seriously contend that good will is not used in the business. As to these propositions there can be no serious controversy.

Good will is property in and of itself. It is intangible in nature. It is something that may be the subject of ownership, may be transferred, and may be protected by law. The term "property" includes good will. The importance of good will property in recent years has been universally recognized.

28 Corpus Juris, 730;

Metropolitan Bank v. *St. Louis Dispatch Co.,* 149 U. S. 436;

Coca Cola Bottling Co. v. *Coca Cola Co.,* 269 Fed. 796;

Washburn v. *National Wall Paper Co.,* 81 Fed. 17.

The Revenue Act of 1918 treats good will as property for invested capital purposes, including it within the definition of intangible property. *Section 325.*

Good will cannot be transferred separate and apart from the business, it fluctuates in value, and in the ordinary case it has an indefinite life. But none of these facts indicate that good will is not property. The court in the *Red Wing Malting* case, *supra,* and the Board of Tax Appeals in *Appeal of Manhattan Brewing Company, supra,* both held that good will was property. Good will has an independent value separate and apart from the value of the tangible assets employed in the business to which it relates. Compensation for the value of the tangible assets would not be compensation for the value of the good will.

Good will property is clearly used in the business exactly as patents, contracts, leases and other intangible assets are used in the business.

Philip Henrici Co. v. *Reinecke,* 3 Fed. (2d) 34;
Kaufman-Straus Co. v. *Lucas,* 12 Fed. (2d) 774.

Good will is therefore "property used in the trade or business" under Section 234(a)(7) of the Revenue Act of 1918.

(b) The good will property of brewing companies was rendered obsolescent in fact when the adoption of prohibition at an ascertainable future date became a certainty.

The Government in its brief here apparently recognizes that if patents, leases and contracts are regarded as subject to exhaustion and obsolescence, good will, having a limited life, must be likewise regarded, and bases its entire position

upon the proposition that the obsolescence allowance has no application to any intangible assets.

In view, however, of the attempted distinction between good will and other intangible assets made by the Court in the *Red Wing Malting* case and by the Board of Tax Appeals in the *Manhattan Brewing Co.* case, some space is taken to show that taxpayer's good will was, in fact, subject to obsolescence during the year ending May 31, 1919.

When the adoption of prohibition at a future date became a certainty, as it did by January 31, 1918, the good will of a brewing company then became property having a definitely limited life, of the same general character as patents, contracts or leases having a limited life, and hence subject to exhaustion or obsolescence. *This is essentially a question of fact, which is settled by the findings of the referee* (R. p. 207).

Good will, like any other asset, can be destroyed if the business of which it forms a part is destroyed. It can become obsolete if the business becomes obsolete. It can be subject to obsolescence if the business is in the process or state of going out of use or becoming obsolete. Under *ordinary* circumstances the life of good will is indefinite and undeterminable. But this is wholly immaterial because under the unusual circumstances created by the impending adoption of Federal prohibition it became clear that the value of the good will of a brewing company would within a short time be destroyed. It was, therefore, in fact becoming obsolete.

On this point the court below said:

> "It is further urged that good will differs from other property subject to depreciation allowance,

because good will has no existence except in connection with a going business and cannot be transferred apart from it. Of course, that is true; but its materiality to the present issue is not apparent. A going business has a value over and above the aggregate value of the tangible property employed in it. Such excess value is nothing more than a recognition that, used in an established business that has won the favor of its customers, the tangibles may be expected to earn in the future as they have in the past. The owner's privilege of so using them, and his privilege of continuing to deal with customers attracted by the established business, are property of value. This latter privilege is known as good will. It can, it is true, be exercised only in connection with the exercise of the former; hence it cannot be separately assigned, and legislation which cuts short the use of tangibles in the business necessarily limits also the good will. Every consideration which justifies allowance for the 'obsolescence' of the tangibles because of compulsory future discontinuance of the business ought to create a similar allowance for the good will" (R. 308).

Mr. Trammell, in his dissenting opinion in *Appeal of Manhattan Brewing Co.*, 6 B. T. A. 952, at page 967, said:

"Conceding that good will, under ordinary circumstances, is not subject to exhaustion, it does not follow that it is never subject to exhaustion. It is not ordinarily, because, under usual circumstances and conditions, it continues and has an indefinite life. But there is nothing inherent in its nature that makes it impossible under any circumstances for its life to be made definite and limited in duration. It is, in any case, a question of fact to be determined whether its

useful life for any cause arising before or after its acquisition has become limited in duration. If it can be established as a fact that good will has in a particular case become limited in duration, it seems clear that the provision of the statute allowing a deduction on account of exhaustion, including obsolescence, is just as applicable to such property as to any other property. Actual facts in the particular cause before us are controlling over general principles or theories as to what the facts ordinarily are. If the taxpayer's good will did in fact exhaust or was becoming obsolete, the fact that good will ordinarily does not exhaust or depreciate seems to me to be immaterial. The statute is certainly broad enough in its terms to allow the deduction if the fact of obsolescence can be shown. It seems to me that this reduces the question to one of fact, that is, whether during the taxable year the taxpayer's intangible assets were in the process of becoming obsolete or losing their useful value."

If a taxpayer purchased a brewery, and the good will of the brewery business, after the useful life of the good will had been limited, the deduction of annual allowances to cover the cost of the good will clearly would be deductions for exhaustion, just as in the case of a patent or contract having a limited life, and would clearly be allowable under the provisions of the Revenue Act of 1918. Where, as in this case, the life of the good will became limited by some change in external conditions after its acquisition, the annual allowances thereafter to cover the cost of such good will are of precisely the same nature, but may properly be termed allowances for obsolescence, because the useful

life of the good will property has been determined by change in external conditions arising after its acquisiti by the taxpayer.

As stated by the court below:

> "The Referee has found that on January 31, 19 it was reasonably certain that prohibition legislati would be adopted in the near future and that after t Prohibition Amendment became effective on Janua 16, 1920, the plaintiff's good will came to an e Consequently on January 31, 1918, it had beco known that the plaintiff's good will would termin in 715 days. If anyone had purchased plainti brewery and good will on that date, paying, for ill tration, $50,000 for the good will, why should that capital investment of $50,000 be depreciated d ing the limited period of the life of the asset p chased, just as would be done in the case of the p chase price of a patent or a lease having still 715 d to run? In each case the owner has full and conti ous enjoyment while his right endures. It is a conv tion to say that the asset is used up day by day, a c vention adopted to spread the loss equitably. patentee's right or the lessee's are as complete in last year as before; only they will come to an end this good will. To us the cases seem precisely a in this regard, and that every consideration wh justifies spreading the loss in one case justifies spre ing it in the other" (R. 307).

What is in question here is not an allowance for crease in the value of the good-will, as the Governm appears to suggest in its brief (p. 28). It is an allowa based on the fact that the whole value of the good will to be destroyed on the taking effect of prohibition in Ja

ary, 1920. As this made the good will obsolescent, the loss must be spread over the period between the time when this loss of value became inevitable and the time when it occurred. The allowance no more involves the actual fluctuation in value from period to period than the allowance for depreciation or for exhaustion of a patent or the like. The basis for the computation of the allowance in this case, if permitted by the statute, was agreed upon by the parties (R. 206).

Since the taxpayer's good will was property used in its brewing business, and in the course of becoming obsolete during the year ending May 31, 1919, the taxpayer was entitled under the provisions of Section 234(a)(7) of the Revenue Act of 1918 to deduct an allowance for such obsolescence.

III.

There is nothing in the Red Wing Malting opinion or elsewhere which establishes any basis for denying, in the case of good will having a limited useful life, the reasonable allowance for exhaustion, including obsolescence, permitted with respect to other kinds of property.

In view of the petitioner's extensive quotation from the opinion of the court in the case of *Red Wing Malting Co.* v. *Willcuts, supra,* the argument made by that court is here considered, although the brief of petitioner, in its argument on principle, departs from the reasoning of the court.

The underlying theory of the court in the *Red Wing Malting* decision is succinctly stated in the following paragraph:

> "We are satisfied that there can be no wear or tear of good will, or exhaustion thereof *by use,* and, even should we assume that good will, separate and distinct from tangible property, is property used in the business, section 234(a), subdivision (7) of the 1918 Revenue Act limits the allowance for obsolescence to such property as is susceptible to exhaustion, wear and tear *by use* in the business, and good will is not such property" (15 F. (2d) 626, 633). (Italics ours.)

The holding of the court that the 1918 statute requires that exhaustion, wear and tear result *by use,* is erroneous for the reasons stated above (p. 28). The court was led

into this error largely by its misapprehension as to the legislative history. It says:

> "When the Revenue Act of 1918 was before the Congress, the House wrote a provision the same as in the 1916 and 1917 Acts, providing an allowance for 'exhaustion, wear, and tear', of property."

This is incorrect. The 1916 Act read: "Exhaustion, wear and tear of property *arising out of its use in the business or trade.*" The 1918 House Bill read: "Exhaustion, wear and tear of property *used in the trade or business*" (see *supra,* p. 29). The court failed to notice this change, and was thus led to base its opinion on the precise meaning of the word *"including",* a question which is largely immaterial when it is realized that under the 1918 Act exhaustion, wear and tear need not result by use, and hence that, on any theory, there is no basis for limiting the property, to which the statute is applicable, to property subject to exhaustion, wear and tear by use.

The court held that "including" did not mean "and", that the added phrase did not add "a new and independent deduction", and that the phrase was but "a part of and an enlargement of the previous phrase of said sub-section (7) relating to exhaustion, wear and tear". The quotation made by the court from *Blanck, et al.* v. *Pioneer Mining Co., et al.,* 93 Wash. 26, indicates that it regarded the word "including" as a term of enlargement and not a term of limitation, and that it enlarged the otherwise more limited preceding language by introducing the element of obsolescence. So construed, the statute would read "a reasonable allowance for exhaustion, wear and tear (enlarged

to include obsolescence) of property used in the trade or business". Since exhaustion includes exhaustion of value by lapse of time as well as physical exhaustion, and obsolescence always results not from use but from a limitation of useful life by a change in external conditions (see pp. 20 and 17 above), there is nothing in the statute so read to indicate that its application is limited to physical property which is decreased, consumed or disposed of by use.

While the elaborate argument of the Court as to "including" seems beside the point as above indicated, it may be noted that the word "including" often is used in the sense of "and". A striking case of the use of the word "including" in the sense of "and" occurs in the very statutes under consideration.

The Revenue Act of 1916 under Section 12(a) Second provides for the deduction of:

> "All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, *including* a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade." (Italics ours.)

Earlier statutes had used the word "including" in the same way. Corporation Excise Tax Law of Aug. 5, 1909, Sec. 38, paragraph second; Income Tax Law of Oct. 3, 1913, Sec. 2, G. (b).

Obviously the deduction for exhaustion, wear and tear is something entirely distinct and separate from and additional to the deduction for losses actually sustained and charged off. In this provision the word "including" clearly

means "and." Cp. Section 5(a) Revenue Act of 1916; Section 234(a)(4) and (7) Revenue Act of 1918. The draftsmen of Section 234(a)(7) of the Revenue Act of 1918 thus had immediately before them a statute clearly using the word "including" in the sense of "and".

See also

Article 161, Regulations 45 (1919).
Article 201, Regulations 74 (1929).
U. S. v. *Pierce,* 147 Fed. 199.
Hiller v. *U. S.,* 106 Fed. 73.
Sullivan Machinery Company v. *U. S.* 168 Fed. 561.
Jacksonville Terminal Co. v. *Blanshard,* 77 Fla. 855; 82 So. 300.

The question is not what the word "including" means when describing property or a bequest, as in the case of *Montello Salt Company v. Utah,* 221 U. S. 452, but what it means in this Revenue Act, in view of the language and purpose of the statute.

As stated above, the court in the *Red Wing Malting Co.* case did not place its decision on the ground that no intangible property was subject to the provisions of Section 234(a)(7), the main ground now urged by the Government. On the contrary, the court attempted to distinguish good will from other intangible assets. It said:

> "Good will is property of an intangible nature. It differs from such intangibles as patents, copyrights, licenses and franchises because while in a certain sense it inheres in and is used in the business, it is not subject to depreciation as that term is commonly understood and commonly used in the statutes."

The court then quotes accounting authorities to show that good will is not subject to depreciation, all of these, of course, dealing with good will in the ordinary case of a continuing business where the good will has an indefinite life, and not with the case before the court, where the good will had a fixed remaining useful life.

In *Appeal of Manhattan Brewing Co.*, 6 B. T. A. 952, the Board of Tax Appeals expressly said that intangible assets such as patents, copyrights and leases were subject to exhaustion and obsolescence (p. 960), but attempted to differentiate good will from such assets on the ground that good will was an inseparable part of the business which ordinarily did not have a limited life.

The Government, in its brief, suggests no new distinction between good will and other intangible assets (see pp. 27, 28, Petitioner's brief).

The differences between good will and other intangible assets so suggested are (1) that good will is an integral part of a going business, and (2) that it does not depreciate *in the ordinary case*, but merely flunctuates in value. These differences are, however, immaterial as applied to a case where the good will in fact has a limited useful life and is being totally destroyed by prohibitory legislation together with the business of which it is a part. Recognition of the unsoundness of the attempted differentiation is presumably the reason for the Government's reliance on the wholly novel contention that Section 234(a)(7) applies only to physical property.

IV.

The decision of the Circuit Court of Appeals should be affirmed.

The taxpayer had a good will in connection with its brewery business which was worth $174,482.64 on March 1, 1913. From January 31, 1918 it was apparent that the brewery business and the useful life of the brewery good will would terminate not later than January 16, 1920. During such period the good will property used in the business was in the state of becoming obsolete—its value was being exhausted by lapse of time. The taxpayer's good will was wholly destroyed by prohibition legislation. The statute provides without restriction for the deduction of a reasonable allowance for exhaustion, including obsolescence, of property used in the trade or business. The taxpayer should therefore be allowed to deduct from income of the year ending May 31, 1919, the amount which has been agreed upon by the parties as a reasonable allowance for such year for the obsolescence of its good will. The decision of the Circuit Court of Appeals herein should be affirmed.

Respectfully submittted,

ARTHUR A. BALLANTINE,
GEORGE E. CLEARY,
Attorneys for The Haberle Crystal Springs Brewing Company, Respondent.

APPENDIX A.

Rulings and decisions holding that deductions for exhaustion, wear and tear, including obsolescence, are allowable with respect to intangible, as well as tangible, property.

The Regulations of the Bureau of Internal Revenue have uniformly construed the word "property" as used in Section 234(a)(7) of the Revenue Act of 1918 and similar sections, as including intangible property. Article 163 of Regulations 45, 62, 65 and 69, and Article 203 of Regulations 74, issued under the Revenue Act of 1918, 1921, 1924, 1926 and 1928, respectively, provide as follows:

> "Intangibles, the use of which in the trade or business is definitely limited in duration, may be the subject of a depreciation allowance. Examples are patents and copyrights, licenses, and franchises."

The Bureau of Internal Revenue has from the outset allowed a deduction for exhaustion of patents and copyrights.

Article 137, Regulations 33. (Issued under 1913 Income Tax Law.)

Article 174, Regulations 33, Revised. (Issued under Revenue Acts of 1916, 1917.)

Article 167 of Regulations 45, 62, 65 and 69. (Issued under Revenue Acts of 1918, 1921, 1924 and 1926.)

Article 207, Regulations 74. (Issued under Revenue Act of 1928.)

After first deciding to the contrary (T. D. 3414, I-2 C. B. 90, November 25, 1922), the Bureau of Internal Revenue allowed a deduction for exhaustion of leases, this decision being made after decisions by the courts and Board of Tax Appeals that leases were property subject to exhaustion. *T. D. 3760, IV-2,* C. B. 154 (issued October 10, 1925), provides:

> "A lessee is entitled under the Revenue Acts of 1916, 1917, 1918 and 1921 to an allowance for the exhaustion of a lease used in trade or business based on the value of the lease as of March 1, 1913, if acquired prior thereto. In the case of a lease acquired by purchase subsequent to March 1, 1913, for use in trade or business, the purchaser may take as a deduction in his return an aliquot part of the amount paid for the lease based on the number of years the lease has to run."

The deduction for exhaustion of leases is not limited in practice to leases of depreciable or depletable property, such as buildings or mines, but applies as well to leases of agricultural land, and leases of land and buildings.

There are many rulings of the Bureau of Internal Revenue dealing with various aspects of the exhaustion, wear and tear, including obsolescence, of intangible property, but there is no ruling taking the position that the statute does not provide for such deductions with respect to intangible property because of its character as such.

This uniform practice of the Bureau of Internal Revenue in treating the word "property" as used in the statute in question as including intangible property, has been uni-

formly approved by the Board of Tax Appeals and by the courts.

Lynch v. *Alworth-Stephens Co.*, 267 U. S. 364. (Exhaustion of lease of mining property.)

Kaufman-Straus Co. v. *Lucas*, 12 F. (2d) 774 (6th C. C. A.). (Lease.)

Philip Henrici Co. v. *Reinecke*, 3 F. (2d) 34. (Lease.)

"Just as surely as time passes, the admitted $370,000 market value of this lease on March 1, 1913, will be wholly exhausted on April 30, 1928; and unless plaintiff shall have had the right of deduction from year to year of this, its capital so exhausted in the business, it will not only have consumed in its business this capital sum, but will have been obliged to pay an income tax upon it—a result which I believe the law did not intend and does not require" (p. 36).

United Profit-Sharing Corporation v. *United States* Ct. Cl. (June 18, 1928). (Contract.)

Perfect Window Regulator Co. v. *United States*, Ct. Cl. (June 18, 1928). (Patent.)

International Curtis Marine T. Co. v. *United States*, 63 Ct. Cl. 597. (Patent license contract.)

Kentucky Tobacco Products Co. v. *Lucas*, 5 F. (2d) 723. (Contract.)

Legett & Platt Spring Bed Co. v. *Crooks.* D. C. W. D. Mo. (1929). (Patent.)

Appeal of Hotel de France Co., 1 B. T. A. 28. (Lease of hotel.)

Appeal of Grosvenor Atterbury, 1 B. T. A. 169. (Lease of building.)

Appeal of Union Metal Manufacturing Co., 1 B. T. A. 395. (Patents.)

"We have been shown nothing in any of the Revenue Acts nor in general rules of law to the effect that deductions for exhaustion, wear and tear or obsolescence in the computation of taxable income should be governed by one rule in the case of tangible assets and leases and by another rule in the case of patents. * * *

Section 214(a) (8) of the Revenue Act of 1918 provides for a deduction of a reasonable allowance for exhaustion, etc., of *property used in the trade or business*. We know of no ground for holding that this means *all property except patents*" (p. 398). (Italics by the Board.)

Appeal of Service Recorder Co., 2 B. T. A. 96. (Patent license agreement.)

Appeal of Atlantic Carton Corp., 2 B. T. A. 380. (Contract.)

Appeal of St. Louis Screw Co., 2 B. T. A. 649, 659. (Patents.)

Appeal of J. J. Gray, Jr., 2 B. T. A. 672. (Patents.)

Appeal of The Topeka Tent & Awning Co., 3 B. T. A. 521. (Patents.)

Appeal of H. B. Hill, 3 B. T. A. 761. (Contract.)

Appeal of Individual Towel & Cabinet Service Co., 5 B. T. A. 158. (Patent application after issuance of patent.)

Autovent Fan & Blower Co. v. *Commissioner,* 5 B. T. A. 282. (Patent.)

Appeal of Nice Ball Bearing Co., 5 B. T. A. 484. (Patent.)

Appeal of J. M. & M. S. Browning, 6 B. T. A. 914. (Right to receive royalties under patent license agreement.)

Appeal of Secor Hotel Co., 7 B. T. A. 158. (Lease of hotel.)

Deltox Grass Rug Co. v. *Commissioner,* 7 B. T. A. 811. (Patent.)

Charles G. Barnes et al. v. *Commissioner,* 8 B. T. A. 360. (Right to receive royalties on patents.)

Owens Bottle Co. v. *Commissioner,* 8 B. T. A. 1197. (Patent license agreement.)

Mead Cycle Co. v. *Commissioner,* 10 B. T. A. 887. (Leasehold.)

Van Kannel Revolving Door Co. v. *Commissioner,* 11 B. T. A. 1209. (Patent.)

Oahu Sugar Co. v. *Commissioner,* 13 B. T. A. 404. (Lease agricultural land.)

"The right to a deduction for exhaustion of such an asset (leaseholds of sugar cane lands) is not questioned, the Commissioner having acquiesced in the decision of the Board in Grosvenor Atterbury, 1 B. T. A. 169. The parties differ only as to the value of the leaseholds on the basic date" (p. 408).

Ewa Plantation Co. v. *Commissioner,* 13 B. T. A. 625. (Lease agricultural land.)

Hawaiian Sugar Co. v. *Commissioner,* 13 B. T. A. 683. (Lease agricultural land.)

Hershey Mfg. Co. v. *Commissioner,* 14 B. T. A. 867. (Patent application after issuance of patent.)

Western Wheeled Scraper Co. v. *Commissioner,* 14 B. T. A. 496. (Patents.)

Ball & Roller Bearing Co. v. *Commissioner,* 15 B. T. A. 862. (Patent application after issuance of patent.)

Hess Building Co. v. *Commissioner,* 15 B. T. A. 891. (Lease.)

Hotel Wisconsin Realty Co. v. *Commissioner,* 16 B. T. A. 334. (Lease.)

Kensington Water Co. v. *Commissioner,* 16 B. T. A. 630. (Franchise.)

Modern Inventions Co. v. *Commissioner,* 16 B. T. A. 1267. (Patents.)

Farmers Feed Co. v. *Commissioner,* 17 B. T. A. 507. (Patents and contracts.)

John A. Maguire Estate v. *Commissioner,* 17 B. T. A. 394. (Lease of cattle ranch.)

Christensen Machine Company v. *Commissioner,* 17 B. T. A.————(November 19, 1929). (Contract.)

In *Appeal of Manhattan Brewing Company,* 6 B. T. A. 952, at p. 960, the Board of Tax Appeals says:

"The sole purpose of the provision in question is to permit the recovery of the cost on March 1, 1913, value of an asset during its useful life if it is used in the trade or business of its owner. Tangible assets deteriorate with use, and the measure of such

deterioration is readily established by proof of
tain facts. The law recognizes the possibility
exhaustion from other than physical causes an
provides that any allowances on account of wear
tear may include a reasonable allowance for obs
cence. *Patents, copyrights, leaseholds, and sim*
intangibles do not suffer any physical deterioratio
use, but, as their life is limited by contract, they
crease in value or become exhausted by the
passage of years. Ordinarily the annual allowa
for the exhaustion of such property is an aliquot
of their cost or capital value at March 1, 1913, fo
number of years to elapse prior to the terminatio
the contract period, but in extraordinary condit
as with tangibles, the allowance for exhaustion
be increased to include obsolescence." (Italics
plied.)